

# *Do Boards Impact Returns?*

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# Boards oversee the administrative and investment activities of plans.

1. *Administrative*: collecting contributions; paying benefits; hiring and firing key employees (e.g., CEO, CIO, legal counsel, and internal auditor); appointing consultants; and setting the administrative budget.
2. *Actuarial*: certifying the contribution rate determined by the actuary and approving key actuarial assumptions such as the investment return used to calculate actuarial contributions.
3. *Investment*: determining target asset allocation and developing an investment policy.

# However, boards can often be constrained in fulfilling their duties.

1. *Administrative*: hiring and retaining high-quality personnel is often hampered by government salary limits that are uncompetitive with the private sector.
2. *Investment*: statutory limits on permissible investment options (as stipulated by “legal lists”) can restrict board members from developing the portfolio mix that best achieves their investment strategy.
3. *Contributions and Benefits*: most boards cannot change plan benefits or set the contribution rates that employers and employees must pay.

# Even so, prior research has shown that board characteristics relate to plan outcomes.

1. *Andonov, Bauer, and Cremers (2017); and Andonov, Hochberg, and Rauh (2018)* demonstrate a relationship between the proportion of board members with financial expertise and the investment performance of pension funds.
2. *Harper (2008); and Clark and Urwin (2007)* demonstrate a positive relationship between smaller boards and financial outcomes.
3. *Mitchell and Yang (2005)* demonstrates a negative relationship between retired members on the board and investment outcomes.

The CRR identified key features that play a role in board effectiveness.

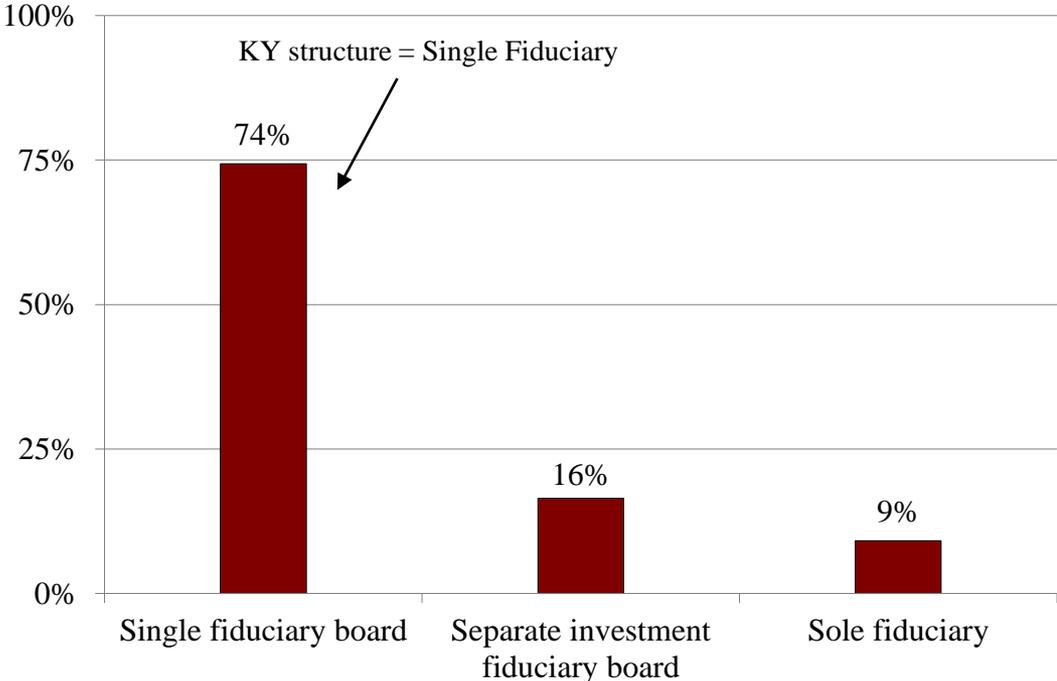
1. Structure of the board
2. Composition of board members
3. Size of the board
4. Turnover of board members

# And analyzed the sample of plans in the Public Plans Database (PPD).

- The PPD sample includes roughly 200 state and local defined benefit pension plans (half state plans, half local plans).
- It covers 95 percent of public pension members and assets.
- Currently, the data span 2001-2018.
- The PPD is updated quarterly by manually collecting data from recently released CAFRs and actuarial valuations.

# The vast majority of PPD plans have a single fiduciary board.

Percentage of Public Plans by Board Structure, 2017

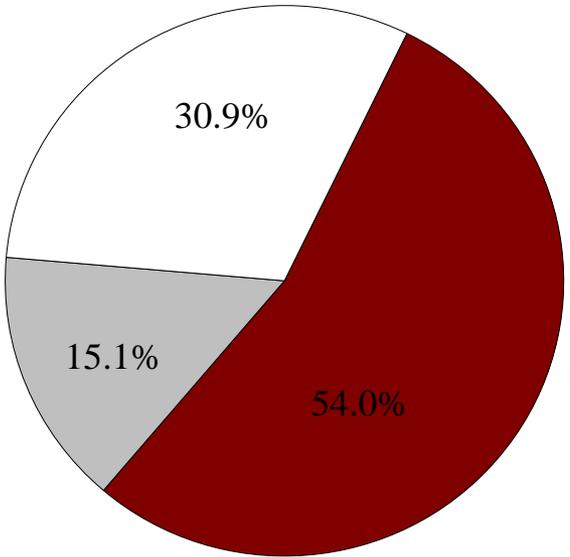


Source: Does Public Pension Board Composition Impact Returns? (2019)

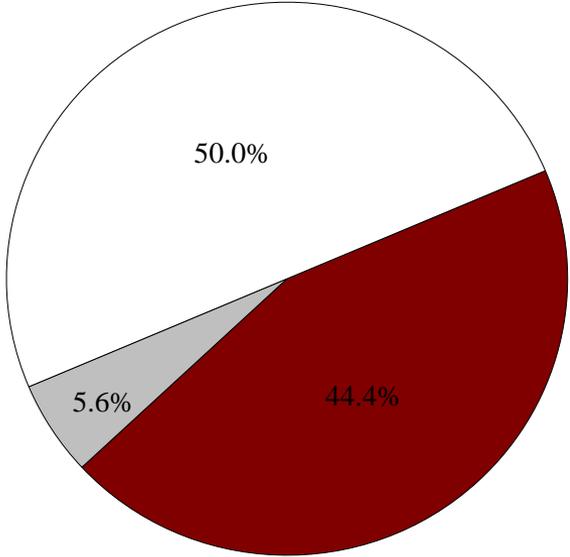
# On average, just over half of board members are plan participants.

Composition of Public Pension Board Membership, 2017

Average for Large Public Plans



Kentucky

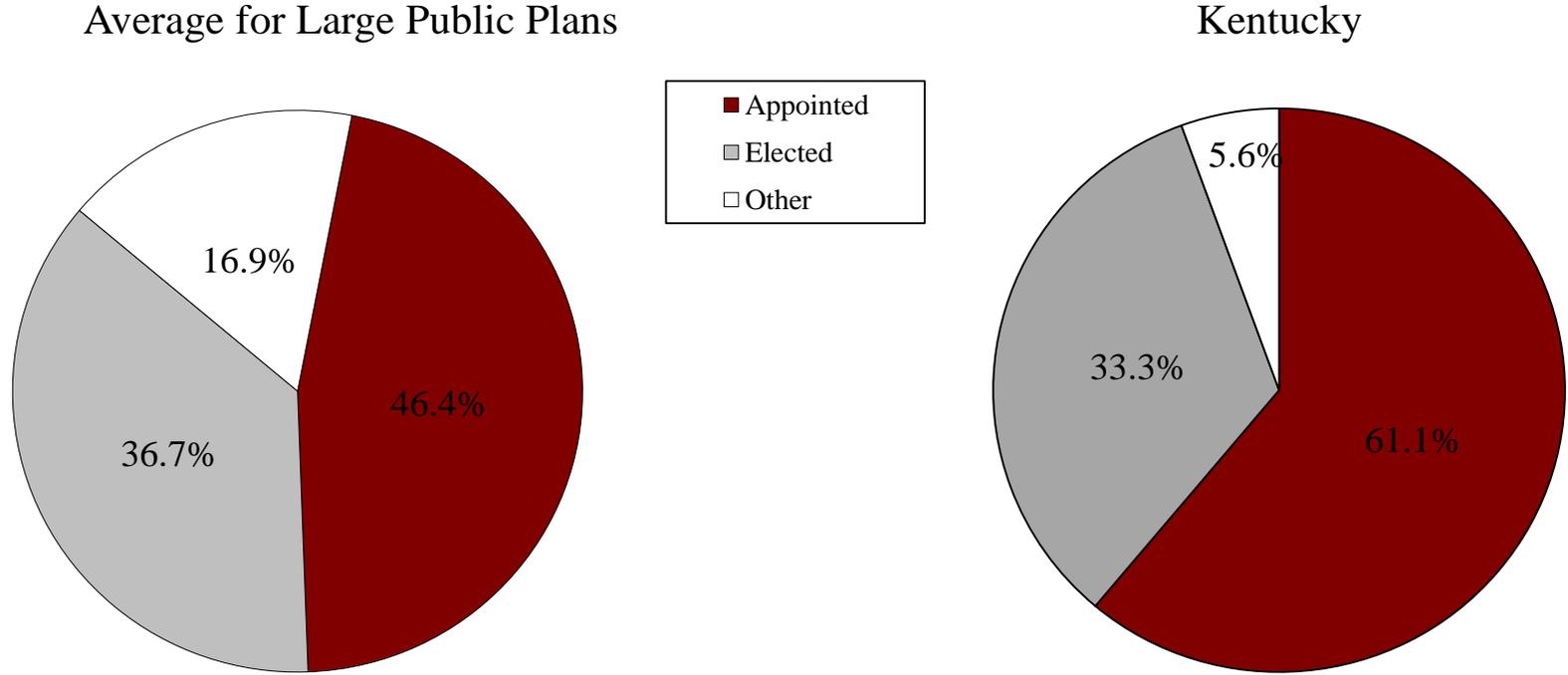


- Plan participants
- Ex-officio
- General public

Source: Does Public Pension Board Composition Impact Returns? (2019); Kentucky Retirement System's Comprehensive Annual Financial Report (2017).

# And, half are explicitly appointed.

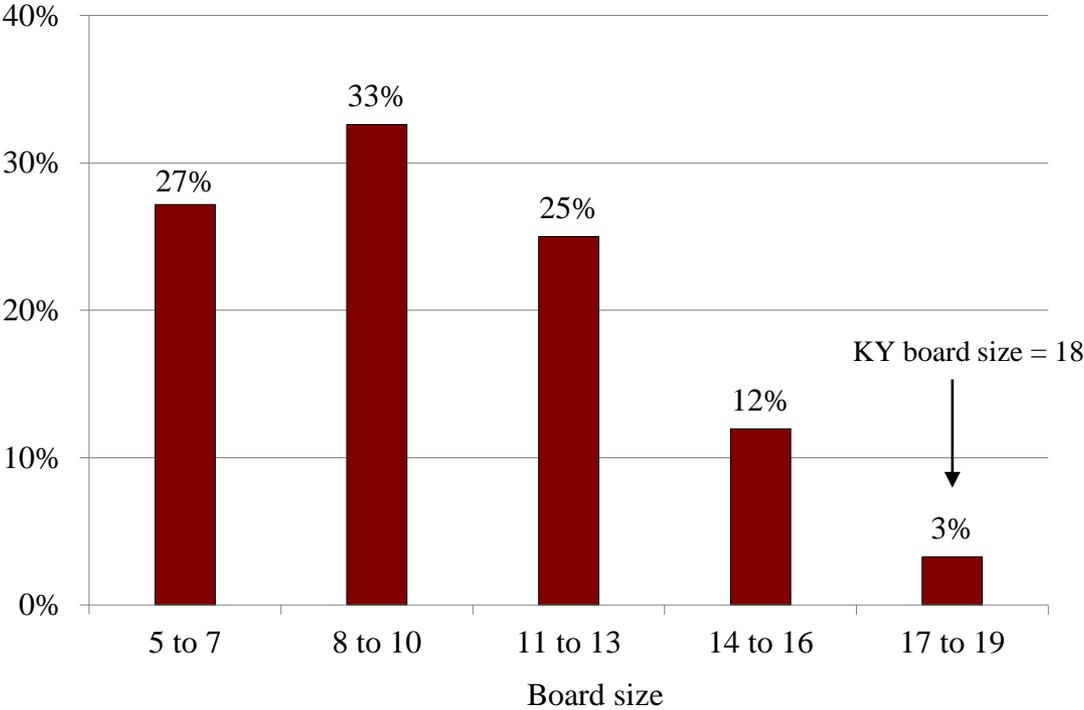
Composition of Public Pension Board Membership, 2017



Source: Author's calculations based on "Composition of Public Retirement System Boards: National Association of State Retirement Administrators (2018); Kentucky Retirement System's Comprehensive Annual Financial Report (2017).

# The average board size in 2017 was 10 members, but ranged anywhere from 5 to 19.

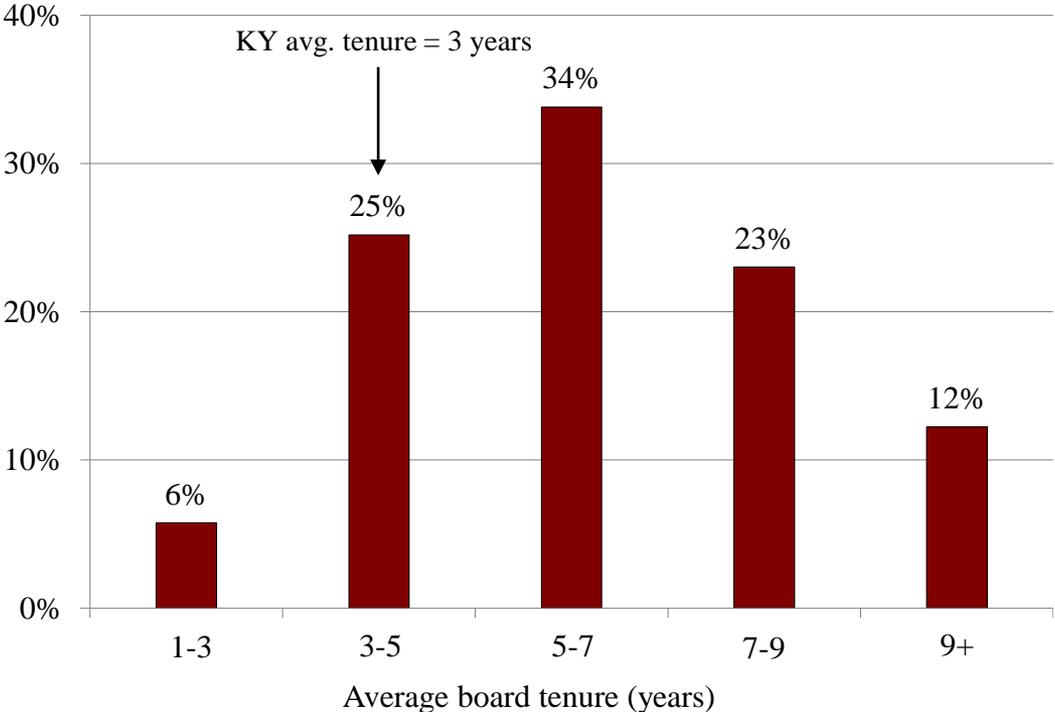
Distribution of Public Plans by Board Member Size, 2017



Source: Does Public Pension Board Composition Impact Returns? (2019)

# The average tenure on boards in 2017 was about 6 years.

Distribution of Public Plans by Average Board Member Tenure, 2017



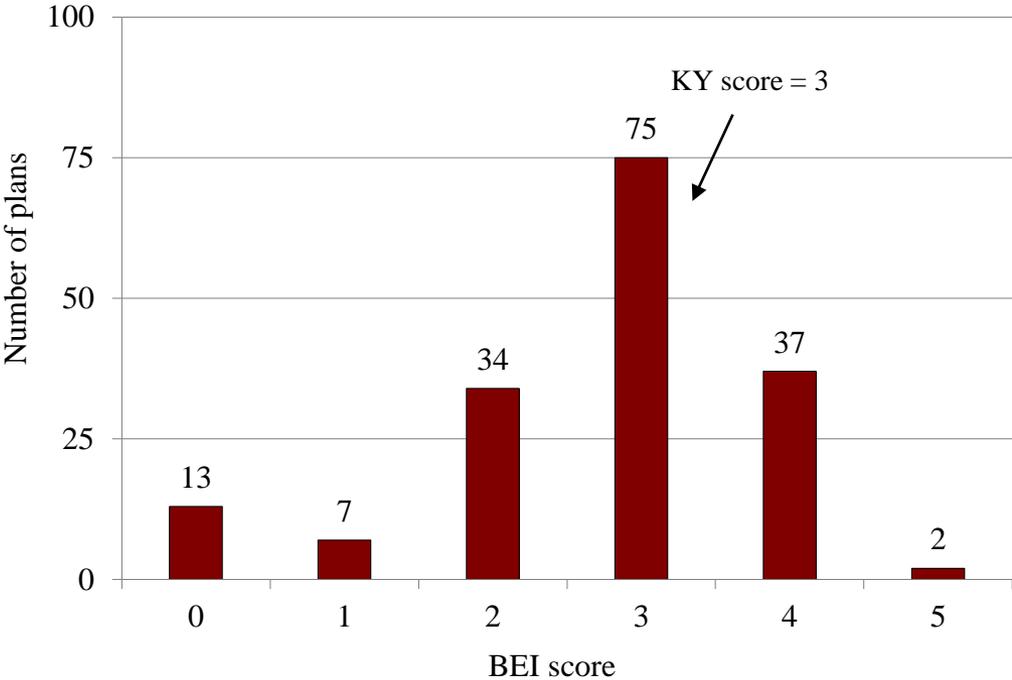
Source: Does Public Pension Board Composition Impact Returns? (2019)

# Plans received a point for being within the suggested range for a particular board feature.

- *Structure*: one fiduciary board for both investment and administrative oversight.
- *Size*: 6-10 board members.
- *Stakeholder representation*: at least one ex-officio member and only 20-70 percent plan participants.
- *Financial expertise*: at least two members with financial or actuarial experience.
- *Tenure*: 8-10 years of tenure, on average.

# The most common total score was three, but all possible total scores occurred in the data.

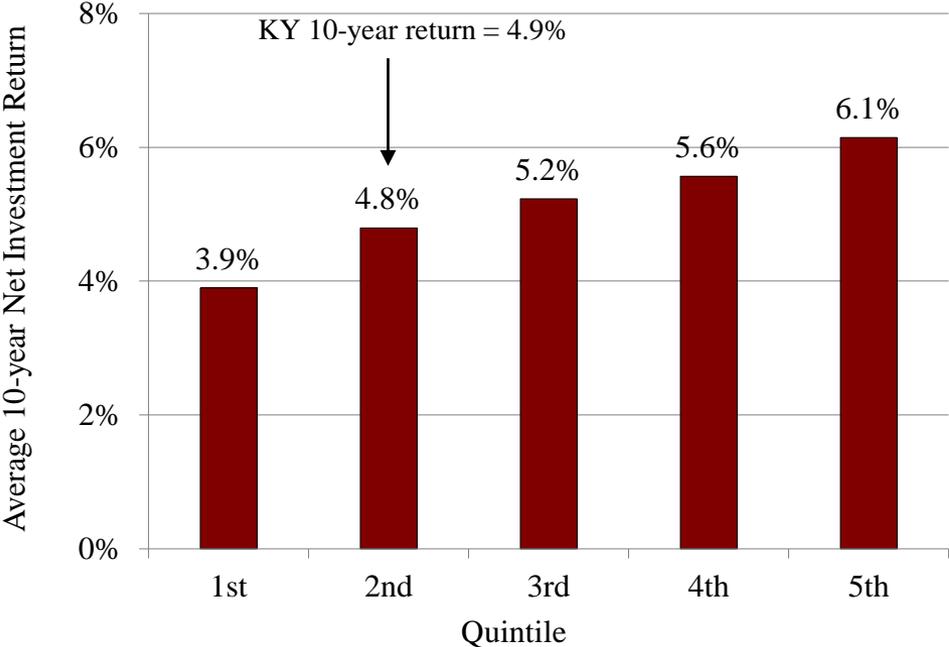
Number of Plans by Board Effectiveness Index Score, 2017



Source: Does Public Pension Board Composition Impact Returns? (2019)

# The analysis related each plan's total score to its 10-year investment return in 2017...

FY 2017 Average Annualized 10-year Net Investment Return, by Quintile



Source: Authors' calculations based on PPD.

...and found that higher scores were correlated with better 10-year performance.

Impact of Board Effectiveness Index on 10-Year Investment Return, 2017

Variable name	Coefficients
Board effectiveness index	0.0014 (0.0001)
Fiscal Year End	0.0008 *** (.0002)
Total plan membership	0.0000 (0.0000)
R-squared	0.07
Number of plans	145

Note: Board effectiveness index is statistically significant at the 15-percent level; Fiscal year end is statistically significant at the 1-percent level (\*\*\*).

Source: Authors' calculations.

# Conclusion

- Boards are responsible for oversight of both the administrative and investment activities of plans.
- Boards exhibit significant diversity across key features related to their effectiveness – board structure, size, composition, and turnover.
- The CRR found a positive relationship between best practices in these areas and a plan's 10-year investment return.
- The result supports the belief that best practices recommended by governance experts relate to tangible plan outcomes.

- [The Center for Retirement Research at Boston College \(CRR\)](#)
- [CRR - State and Local Pension Research](#)
- [CRR - Pension Investment Comparison Tool \(Beta\)](#)
- [Public Plans Database \(PPD\)](#)

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# Appendix

Many large pension plans have a similar organizational structure to the Kentucky Retirement Systems, where separate state and local plans are jointly administered.

Alabama ERS

California PERS

Indiana PERS

Maine PERS

Maryland PERS

New Jersey PERS

NJ Police and Fire

North Carolina

Rhode ERS

Tennessee Retirement System

Utah RS

Virginia RS